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Supreme Court of the United States

OCTOBER TERM, 1953

No. 214

INDUSTRIAL COMMISSIONER OF THE STATE OF NEW YORK,

Petitioner,

vs.

SWORD LINE, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Supreme Court of the United States

OCTOBER TERM, 1953

No.

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of
SWORD LINE, INC.,
Debtor,

INDUSTRIAL COMMISSIONER OF THE STATE OF NEW YORK,
Petitioner,

vs.

SWORD LINE, INC.,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Attorney General of the State of New York, on behalf of the Industrial Commissioner of the State of New York, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this case on April 27, 1954. The judgment reversed the order of the District Court and remanded the cause to that tribunal (R. 37-38).

Opinions Below

The referee in bankruptcy did not render a written opinion. He did, however, sign findings of fact and conclusions of law (R. 3-8, 10, 19). The opinion of the District Court (R. 9-14) and the majority and dissenting opinions of the Court of Appeals (R. 17-37) were not reported officially at the time of the preparation of this petition.

Jurisdiction

The jurisdiction of this Court to review the judgment of the Court of Appeals, which was entered on April 27, 1954 (R. 37-38), is invoked under the provisions of 28 U. S. C. § 1254, subd. (1).

Questions Presented

1) Whether, under the facts and circumstances of this case, the Court of Appeals was correct in its ruling that it had jurisdiction to determine the liability of the debtor for post-arrangement interest after the confirmation of the arrangement and close of the proceeding.

2) Whether the Court of Appeals erred on the law in concluding that such interest did not arise during the course of the arrangement proceeding and that the debtor will not be liable therefor after the confirmation of the arrangement and close of the proceeding.

Statutes Involved

The pertinent statutory provisions are printed in the Appendix, *infra.*, pp. 18-22.

Statement

A petition for an arrangement under Chapter XI of the Bankruptcy Act, Sections 301 *et seq.* (11 U. S. C. Section 701 *et seq.*), was filed by the debtor and approved on July 30, 1948 (R. 3, 9, 18). On the same day, the District Court entered an order enjoining and staying until final decree all persons from the commencement of any suit against the debtor (R. 4, 9, 18).

On July 24, 1950, petitioner filed a claim for New York State unemployment insurance taxes and by reason of the inclusion therein of interest beyond the date of the filing of the petition, the debtor interposed an objection thereto (R. 5, 9, 18). A hearing on the objection was thereafter adjourned from time to time pending a decision by this Court in *United States* v. *General Engineering & Manufacturing Co.* (1952), 342 U. S. 912 (R. 5, 6, 18), and upon the rendition of that decision and in conformity therewith, petitioner filed an amended claim, which included interest only up to the date of the filing of the petition (R. 6, 10, 18). This claim was allowed by the referee in bankruptcy on July 2, 1952 (R. 6, 10, 18), the same day on which he determined the debtor would not be liable in any other forum, after the close of the proceeding, for interest "accruing" (R. 8) after the date of the petition (R. 7, 8, 19).

On June 4, 1952, before the allowance and payment of the amended claim and without leave of the bankruptcy court, petitioner filed in the Office of the Clerk of the County of New York, pursuant to Section 573, subdivision 2, of the New York State Labor Law, a warrant which included post-arrangement interest (R. 6, 10, 18). The debtor thereupon moved before the referee for (1) an order expunging

the warrant from the judgment docket, (2) a permanent injunction against any proceeding by petitioner to collect post-arrangement interest outside the bankruptcy court, and (3) a determination of the question whether or not interest arose on the claim of petitioner after the date of the filing of the petition (R. 19). Following rulings that petitioner voluntarily submitted himself to the jurisdiction of the bankruptcy court; that he had knowledge of the proceedings with respect to the determination of the debtor's liability; and that he had knowledge of and was bound by the Court's stay against the institution of any other proceeding, the referee held that petitioner was not empowered to issue, file or levy execution under the warrant or resort to any other summary process to collect such interest in any proceeding other than before the bankruptcy court (R. 7, 10).

In the interim, between the date of this determination by the referee and the petition for review of the order based thereon, the plan of arrangement was confirmed and the amended claim, which excluded post-interest, was paid in full (R. 2, 10, 18).

On review of the referee's order, petitioner offered no objection to that part of the order which temporarily restrained him from levying execution under the warrant until the entry of a final decree. The issues before the District Court were limited to the jurisdiction of the referee to permanently enjoin the collection of post-arrangement interest or to determine the debtor's liability therefor, the survivability of post-arrangement interest, the alleged violation of the stay order by the filing of the warrant, and the jurisdiction of the referee to direct the vacation of a warrant docketed in another court (R. 10, 11).

On March 13, 1953, the District Court rendered an opinion vacating the permanent injunction, but continuing it temporarily until the entry of a final decree (R. 14, 19).

The District Court reasoned that since § 11 (a) of the Bankruptcy Act (11 U. S. C. 29a) was limited to suits pending against a bankrupt at the time of the filing of a petition on dischargeable claims, and then only until discharge, the permanent injunction could not be sustained thereunder. Although ruling that the threatened interference with the bankruptcy court's possession, custody or orderly administration of the bankruptcy estate, warranted the issuance of a temporary injunction under § 2a (15) of the Act (11 U. S. C. 11a (15)), the court stated that even after a final decree or order of discharge has been entered (which was not the case here), a bankruptcy court should not act to determine whether a specific claim has been discharged; that such decision should be reserved to the court where the claim is sought to be enforced; that the filing of the claim was a submission only of the question whether interest therein included should be allowed, and not a submission of whether interest should be discharged; and that since there was no statutory authority for the referee's determination of the bankrupt's liability subsequent to the closing of the estate, he was not empowered to permanently enjoin the collection thereof. The District Court also directed that the order of the referee was not to be construed as an adjudication that the claim was invalid or that it had been paid; it upheld the authority of the referee to direct a vacation of the warrant; and it determined, on the reasoning that *City of New York* v. *Saper* (1949), 336 U. S. 328, was inapplicable, that the interest would nevertheless survive the proceeding (R. 11-14).

On March 26, 1953, the District Court entered an order on the opinion (R. 15) and the debtor thereupon appealed

from those portions of the order which vacated the permanent injunction and directed that the order of the referee was not to be construed as an adjudication that the claim for post-arrangement interest was either invalid or that it had been paid (R. 3). Petitioner thereafter complied with that portion of the order which directed that the warrant be expunged from the judgment docket (R. 19).

On April 27, 1953, the United States Court of Appeals for the Second Circuit, by Charles E. Clark, Circuit Judge, rendered an opinion reversing the order of the lower court and remanding the case to that tribunal for further proceedings (R. 18-27). The court upheld the permanent injunction mainly upon the authority of the *Saper* case and in so ruling, held that the interest in issue was not merely suspended during the pendency of the proceeding and that it could not be collected from the debtor after confirmation (R. 23-25). Circuit Judge Jerome N. Frank filed an opinion in which he dissented from the majority view of the court (R. 27-37).

The Court of Appeals ruled that injunctive relief was not premature despite the fact that the District Court had refrained from making a final adjudication and petitioner had not appealed from the order expunging the warrant from the judgment docket (R. 20). The Court determined it was empowered to grant the relief because the direct holding of the referee, which would have settled the question, was expunged; there was an absence of adequate protection for the plan of arrangement; there was a direct threat of steps to collect; and the plan of arrangement, recognizing the insolvency of the bankrupt, had since been confirmed and payments had been made to carry it out (R. 20).

Circuit Judge Jerome N. Frank, in the dissenting opinion, stated that no court had theretofore considered the question of whether confirmation of a Chapter XI proceeding discharged post-interest (R. 28). He analyzed the authorities, particularly the *Saper* case, and concluded that interest was merely suspended; that by reason of insolvency, it was not allowable; and since it was not allowable, it came within the exception to the discharge provisions of Section 17 of the Bankruptcy Act (11 U. S. C. 35) (R. 31, 34, 35).

Penalties are not in issue, objection to the same having been withdrawn by respondent before the Court of Appeals.

Reasons Relied Upon for Allowance of the Writ

The following are respectfully submitted by your petitioner and relied upon as reasons for the granting of the writ:

a) The United States Court of Appeals for the Second Circuit has held that post-arrangement interest did not arise during the course of the proceeding and that the debtor will not be liable therefor upon the termination thereof. This ruling is in conflict with applicable decisions of this Court, particularly *City of New York* v. *Saper* (1949), 336 U. S. 328, which merely held that bankrupt estates cannot be directly used to pay post-bankruptcy interest on claims for unpaid taxes; *United States* v. *General Engineering & Manufacturing Co.* (1952), 342 U. S. 912, which extended the rule to Chapter XI proceedings; *United States* v. *Bloom* (1952), 342 U. S. 912, which extended the rule to general assignment proceedings under the *New York State Debtor and Creditor Law; Johnson* v. *Norris* (C. A. 5th, 1911), 190 Fed. 459, appeal dism'd.

Norris v. *Johnson,* 232 U. S. 715, cert. den. 232 U. S. 723, *Am. Iron Co.* v. *Seaboard Airline* (1914), 233 U. S. 261, and *Littleton* v. *Kincaid* (C. A. 4th, 1950), 179 F. 2d 848, cert. den. 340 U. S. 809, which held that claims do not lose their interest bearing qualities when funds are in *custodia legis: Sexton* v. *Dreyfus* (1911), 219 U. S. 339, which held that if securities held by a creditor produce interest or dividends during bankruptcy, such amounts should be applied to post-bankruptcy interest; *Macomb Trailer Coach, In re* (C. A. 6th, 1953), 200 F. 2d 611, cert. den. 345 U. S. 958, *Vanston Committee* v. *Green* (1946), 329 U. S. 156, and *Coder* v. *Arts* (1909), 213 U. S. 223, which held that if a secured claim is worth more than the sum of principal and interest due, the creditor, under those circumstances, is also entitled to payment of post-bankruptcy interest.

Taxing authorities throughout the country are affected by the ruling and substantial sums of money are at stake. The issue is not free from doubt and public interest requires that this important and fundamental question of law be reexamined. As a matter of fact, Circuit Judge Jerome N. Frank, in his dissenting opinion, stated (R. 27-28):

> "1. The cases cited by my colleagues (which I shall discuss later) have decided only that post-petition interest on a tax claim is not allowable unless a debtor becomes solvent during the bankruptcy proceeding. A different question is before us here, viz. whether confirmation of a Chapter XI arrangement discharges such interest, if it has not been allowed (i. e. when the debtor has not thus become solvent). *No court has heretofore considered this question.*" (Italics for emphasis.)

No language in the *Saper* or *General Engineering* cases outlaws post-petition interest for all time. Mere disallowance in the particular proceeding is all that was intended.

While the possibility of making interest on tax claims dischargeable by judicial construction is not referred to in the opinion of this Court in the *Saper* case, the same Court of Appeals in considering the argument that interest on tax claims survives against a bankrupt even after payment of the tax claims themselves, stated the following (*Saper* v. *City of New York* (C. A. 2nd, 1948), 168 F. 2d 268, 271-272):

> "* * * But assuming arguendo that interest is not discharged upon payment of the tax claim, we do not see how that fact can be decisive on the present issue. * * * The fact that the bankrupt may not have received an immunity he might desire is not ground for upsetting the statutory scheme of distribution of the estate in the hands of the trustee * * *"

The bankruptcy rule merely suspends or postpones the accrual of interest during bankruptcy, but claims do not lose their interest bearing qualities. It s merely a rule of convenience and equity in distribution during a particular insolvency proceeding.

In the absence of a controlling provision in the Bankruptcy Act, the general law should control (*Johnson* v. *Norris, supra*) and where interest on New York State unemployment insurance taxes is concerned, there is more than the general law to indicate payment should be made. Such interest is as much a part of the tax as the tax itself (*Labor Law, Section 570, subd. 3; Matter of Pavone Textile Corp. (Bloom)*, 302 N. Y. 206) and since it is disallowable under the *Saper* and *General Engineering* cases, it is non-dischargeable under § 17, subdivision 1, of the Bankruptcy Act (11 U. S. C. 35 (1)).

In *Littleton* v. *Kincaid, supra*, after citing the *Saper* case for the proposition that ordinarily interest on claims against a bankrupt estate runs to the filing of the petition

in bankruptcy, the court made it clear that the interest was merely suspended (pp. 852-853):

> "* * * Three reasons are usually given for its existance: (a) The delay in payment is not the act of the debtor but is an act of law for the mutual benefit of the creditors. (b) In the case of claims bearing different rates of interest, it would be inequitable to permit the running of interest to increase the proportion of the assets to which some of the creditors are entitled at the expense of the other creditors while the estate is in the process of administration. (c) If all claims bear the same rate of interest, the addition of interest would not change the proportion of assets to which each would be entitled, and the computation may therefore be omitted as a useless act * * *."
>
> "* * * But the reason for the stoppage of interest on funds in *custodia legis* is not because the claims lose their interest bearing quality, but because of the inequality which would otherwise result in the forced distribution in receivership to debts carrying different rates of interest. * * *"

The Court of Appeals in the instant case has inferentially held that post-petition interest did not even arise during the pendency of the proceeding. This is in conflict with the opinion of the Court of Appeals for the Fourth Circuit in *Meinhard, Greeff & Co. Inc.* v. *Brown* (1952), 199 F. 2d 70, which involved the issue of whether a claimant, whose proof of claim had been allowed in a stated amount, without post reorganization interest, could thereafter and in the same proceeding assert against a pledged bond, in accordance with contract, a claim for post-petition interest. The Court stated (p. 74):

> "* * * We do not think, however, that claimant is precluded from asserting against the pledged bond any claim for interest accruing subsequent to the filing of the bankruptcy proceedings or the expense incurred subsequent to the filing of the claim in protecting the collateral securing the claim. The allowance of a claim

in bankruptcy operates ordinarily to estop the claimant as to all matters which were or should have been included in the claim, but not as to matters which could not have been included. Collier on Bankrutcy (14 ed.) vol. 3, p. 193; Remington on Bankruptcy (4 ed.) vol. 5 pp. 462, 463; United States v. American Surety Co., 2 Cir. 56 F. 2d 734, 736; Lesser v. Gray, 236 U. S. 70, 35 S. Ct. 227, 59 L. Ed. 471. So far as the interest here involved is concerned, interest subsequent to the filing of the petition was not provable as a part of the claim in the bankruptcy proceeding. Collier on Bankruptcy (14 ed.) vol. 3, p. 1835; City of New York v. Saper, 336 U. S. 328, 331, 69 S. Ct. 554, 93 L. Ed. 710; United States v. Edens, 4 Cir.; 189 F. 2d 876. Expenses incurred subsequent to filing of the claim were manifestly not includable within the claim and adjudication of the claim should not estop claimant from asserting them. * * *"

The State submits that Judge Jerome N. Frank was correct, in his dissenting opinion, when he stated that *State of New York* v. *Feinberg* (C. A. 2nd, 1953), 204 F. 2d 502, did not involve the question confronting us here. Petitioner, who was the appellant in that proceeding and is fully familiar with what transpired in that case, reiterates that interest accruing during the pendency of that reorganization proceeding was disavowed because of the provisions of Sections 226 and 228 of the Bankruptcy Act (11 U. S. C. 626 and 628). This is borne out by the opinion of the court which said no more than "that the rate of interest on new securities under a Chapter X plan need not vary according to the varying interest rates to which the several creditors had been entitled before bankruptcy" (R. 37).

b) The decision of the Court of Appeals is also in direct conflict with New York State court decisions on the same issue of liability of the debtor for interest.

In *Matter of Paley (Ritholtz)*, 285 N. Y. 641, aff'g. 260 App. Div. 632, the New York Court of Appeals held that a discharge in bankruptcy does not affect a debt or part of a debt that is not provable, *such as after-accruing interest.*

The debtor in that case argued that the discharge in bankruptcy extinguished the debt owing by the bankrupt and consequently the interest thereon, and rendered inoperative against the bankrupt the post-petition interest included in the judgment. The creditor contended that since interest had accrued subsequent to the petition, those items were not provable debts and consequently not affected by the discharge which, by the very terms of the statute and the order of discharge, was limited to provable debts.

Since the New York Court of Appeals affirmed the case without opinion, we quote from the Appellate Division opinion (p. 635):

> "Among debts provable under the Bankruptcy Act, Section 63, subdivision a, clause (1) (11 U. S. Code § 103, subd. a, cl. (1) is any fixed liability evidenced by a note or any instrument in writing 'absolutely owing at the time of the filing of the petition * * * whether then payable or not, with any interest thereon which would have been recoverable at that date.' The item of interest here involved was not due, payable or recoverable at that date; it accrued after that date, *i. e.*, between the date of the petition and the judgment which antedated the discharge. When it accrued, the principal debt had not at that time been discharged; and although the discharge related back to the date of filing the petition, it affected only provable debts. The item of interest in question being 'interest accrued after the filing of the petition' is expressly excluded from provable debts under the provisions of Section 63, subdivision a, clause (5). Accordingly it was not discharged."

c) The decision of the Court of Appeals is also in conflict with federal and state court decisions on a similar issue, the survivability of penalties after bankruptcy.

The law is settled in both jurisdictions that penalties survive bankruptcies, including arrangements.

Federal decisions to the foregoing effect are *Abramson, In re* (C. A. 2nd, 1914), 210 Fed. 878; *York Silk Mfg. Co., In re* (D. C., M. D., Pa., 1911), 188 Fed. 735; aff'd 192 Fed. 81 (C. A. 3rd, 1911), appeal dism'd 232 U. S. 718 (1913), cert. den. 232 U. S. 724 (1913); *Francisco, In re* (D. C., N. D. N. Y., 1917), 245 Fed. 216.

State court decisions are also indicative of the same result (*People of the State of New York* v. *J. G. Menihan Corp.*, 201 Misc. 1037, aff'd. 281 App. Div. 805, aff'd. 306 N. Y. 792; *Matter of Weber*, 212 N. Y. 290; *Matter of Abelove*, 138 Misc. 241).

See also *Collier on Bankruptcy*, 14th ed., Vol. 3, pp. 296, 1819 and 1820.

d) The ruling of the Court of Appeals that injunctive relief against the State of New York was not at that stage premature, based as it was upon clearly erroneous findings of fact and conclusions of law, is in conflict with applicable decisions of this Court, particularly *Local Loan Co.* v. *Hunt* (1934), 292 U. S. 234 and *Baker* v. *Atchison T. & S. F. Ry. Co.* (C. A. 10th, 1939), cert. den. 308 U. S. 620.

The *Hunt* case, *supra*, held there is a lack of general power in a bankruptcy court to determine the dischargeability of claims, that ancillary jurisdiction in that respect can be taken only after discharge, and that it must be attended by unusual and compelling circumstances or an inadequacy of protection of a debtor in a non-bankruptcy tribunal.

It is clear that the ancillary jurisdiction envisioned in the *Hunt* case is strictly limited to instances of insufficient remedy invoking a right to equitable relief; it does not extend to or contemplate a general jurisdiction in the bankruptcy court to determine upon application the dischargeability of claims or to enjoin the enforcement of claims in other courts regardless of the bankrupt's remedy (*Collier on Bankruptcy*, 14th ed.; Vol. 1, p. 291).

Aside from the fact the referee exercised ancillary jurisdiction *before* confirmation and discharge of certain debts, so that the advantages of discharge could not have been lost, the record is bare of any evidence entitling the debtor to come within the doctrine established in the *Hunt* case, or any of the other cases which adhere to the same limitation.

The *Atchison* case, *supra*, emphasized the established principle that federal courts should exercise an appropriate reluctance to interfere with the fiscal affairs of a state. This is also evident by the provisions of 28 U. S. C. § 1341, which provides as follows:

> "The district courts shall not enjoin suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy or efficient remedy may be had in the courts of such State."

The Court of Appeals ruled that even though the District Court refrained from a final adjudication and petitioner did not appeal from the order expunging the warrant from the state judgment docket, it still had jurisdiction to decide the issue of the liablity of the debtor for the interest (R. 20). None of the reasons ascribed by the court justified a determination of that issue. The State of New York was already restrained by a temporary injunction and there was no direct threat of steps to collect; the expunging of the direct holding by the referee, which would have settled

the question, did not foreclose the debtor from its remedy in the state courts after the close of the proceeding; the plan of arrangement was still adequately protected by the temporary injunction; and although the plan of arrangement recognizing the insolvency of the bankrupt had then been confirmed and payments made to carry it out, such was not the situation when the issue arose before the referee in bankruptcy.

The debtor is not peculiarly handicapped in asserting in a non-bankruptcy forum its defense of discharge of the post-arrangement interest. The debtor may pay those items under protest and request a refund (Labor Law, Section 570, subd. 5). If that is denied, the debtor may request a hearing before an unemployment insurance referee, with appeals thereafter to the Appeal Board of the New York State Department of Labor, the Appellate Division of the Supreme Court, Third Department, and in a proper case, to the New York Court of Appeals (Labor Law, Sections 620, 621 and 624). These statutes meet the test of due process. If a warrant be docketed as a judgment (Labor Law, Section 573, subd. 2), the debtor would have an adequate remedy by an application for discharge under the provisions of Section 150 of the New York State Debtor and Creditor Law.

e) The Court of Appeals in exercising ancillary jurisdiction has decided an important question of federal bankruptcy law, which has not, but should be, settled by this Court. In upholding the permanent injunction, the Court of Appeals has in effect ruled that the filing of the amended claim, without post-interest, and the filing of the warrant, including such interest, but outside the bankruptcy court, constituted a submission of the question whether the debtor

would be liable for post-interest after the close of the proceeding.

The amended claim, which excluded post-arrangement interest and superseded a previous claim, was filed on April 18, 1952. Commencing on that date, and on July 2, 1952, the date of the referee's adverse ruling, the issue of its allowance was no longer before the referee. Respondent's objection was only directed to the previously filed claim, which included the interest pending a determination by the United States Supreme Court in *United States* v. *General Engineering & Manufacturing Co.* (1952), 342 U. S. 912.

Upon the filing of the amended claim, the issue of the allowance of the interest, as well as its dischargeability, became academic. Under federal law, the referee was not empowered to act thereon (*U. S. Constitution, Art. III,* § 2; *United States* v. *Alaska S. S. Co.* (1920), 253 U. S. 113; *Walling* v. *Shenandoah-Dives Mining Co.* (C. A. 10th, 1943), 134 F. 2d 395; *Cover* v. *Schwartz* (C. A. 2nd, 1942), 133 F. 2d 541). There was no real controversy before the Court.

The previously filed claims which for all intents and purposes was no longer in existence on July 2, 1952, may not be deemed to have been a submission to the bankruptcy court of the liability of the debtor for post-interest after the close of the proceeding. The District Court was correct in its ruling that the filing only brought forth the issue of whether the interest was allowable *in the proceeding* (R. 14).

Neither did the filing of the warrant constitute a submission of the question to the court. The warrant, which was docketed against the debtor before confirmation, pursuant to statute, namely, Section 573, subd. 2, of the New York

State Unemployment Insurance Law (Article 18 of the Labor Law), did not constitute a claim in the proceeding and the only issue created by such filing was whether it violated the stay order or interfered with the orderly administration of the estate in bankruptcy. The limitation of the debtor's remedy was an application for a temporary injunction.

Conclusion

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 17, 1954.

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APPENDIX

Bankruptcy Act (United States Code, Title 11):

"2. Creation of Courts of Bankruptcy and Their Jurisdiction. a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * *

"(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act: * * *

* * *"

"§ 11. Suits By and Against Bankrupts. a. A suit which is founded upon a claim from which a discharge would be a release, and which is pending against a person at the time of the filing of a petition by or against him, shall be stayed until an adjudication or the dismissal of the petition; if such person is adjudged a bankrupt, such action may be further stayed until the question of his discharge is determined by the court after a hearing, or by the bankrupt's filing a waiver of, or having lost, his right to a discharge, or, in the case of a corporation, by its failure to file an application for a discharge within the time prescribed under this Act: * * *"

"§ 17. Debts Not Affected by a Discharge. a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by * * * any State * * *."

"§ 314. The court may, in addition to the relief provided by section 11 of this Act and elsewhere under

this chapter, enjoin or stay *until final decree* the commencement or continuation of suits other than suits to enforce liens upon the property of a debtor, and may, upon notice and for cause shown, enjoin or stay *until final decree* any act or the commencement or continuation of any proceeding to enforce any lien upon the property of a debtor." (italics for emphasis)

"§ 371. The confirmation of an arrangement shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement, except as provided in the arrangement or the order confirming the arrangement, *but excluding such debts as, under section 17 of this Act, are not dischargeable.*" (italics for emphasis)

"§ 372. Upon the consummation of a proceeding under this chapter after confirmation of an arrangement, the court shall enter a final decree discharging the receiver or trustee, if any; closing the estate; and making such provisions, by way of injunction or otherwise, as may be equitable."

United States Code
Title 28

"§ 1341. Taxes by States.

The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

"§ 2283. Stay of State Court proceedings.

A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

New York State Labor Law

"§ 570. Payment of contributions.

• • •

3. Default. An employer who fails to pay contributions required to be made by him to the fund shall pay

interest at the rate of three-fourths of one percentum of the amount of such contributions for each month he is in default. *Such interest shall be assessed, collected and paid as part of the payment required to be made by the employer to the fund.*" (Italics for emphasis.)

* * *

"5. Refunds and credits. If any employer shall make application for a refund of any contribution, interest, or penalty paid by him or for a credit thereof and the commissioner shall determine that such contribution, interest or penalty, or any portion thereof was erroneously collected, the commissioner shall refund said amount or allow a credit therefor, without interest, as specified in this subdivision, unless the employer shall have already deducted said amount by way of credit against moneys payable by him into the fund. No refund or credit shall be allowed unless an application therefor shall be made on or before whichever of the following dates shall be the later: (a) one year from the date on which such payment was made; or (b) three years from the last day of the first month following the end of that calendar quarter during which the remuneration was paid which formed the basis for contributions, interest or penalty claimed to have been erroneously collected. For a like cause and within the same period a refund may be so made or a credit allowed on the initiative of the commissioner. Any credit or refund of interest and penalties erroneously collected, allowed by the commissioner under the foregoing conditions, shall be a charge against the special fund. Any credit or refund of deposits for hearings and appeals, and of contributions erroneously collected, allowed by the commissioner under the foregoing conditions, shall be a charge against the unemployment insurance fund.

* * *"

"§ 620. Referee's hearings.

* * *

2. Contested determinations, rules or orders. Any employer who claims to be aggrieved by the industrial commissioner's determination of the amount of his

ributions or by any other rule or order of the com-
ioner under any provision of this article may
y to the commissioner for a hearing within twenty
after mailing or personal delivery of notice of
determination, rule, or order.

Decisions. Every hearing as herein provided
shall be held by a referee who shall render his
sion within five days after the hearing is concluded.
tten notice of the referee's decision, containing the
ons therefor, shall be promptly given to the claim-
or employer, to the commissioner, and to any party
cted thereby who appeared at the hearing."

§ 621. Appeals to appeal board.

* * *

Contested determinations, rules or orders. With-
wenty days after the mailing or personal delivery
notice of the decision after a hearing on contested
rminations, rules, or orders by the commissioner,
employer may take an appeal to the appeal board,
vided he appeared at the hearing, by filing a notice
ppeal with the commissioner, and the commissioner
likewise within such period take an appeal to the
rd by giving written notice thereof to the employer,
ardless of whether or not the commissioner ap-
red or was represented at the hearing before the
ree.

Conduct of appeals. The appeal board may de-
any case appealed to it under any provision of
article on the basis of the record and of evidence
viously submitted in such case, or it may in its
retion hear argument or hold a further hearing,
remand such case to a referee for such purposes
it may direct. If a further hearing is to be held
argument had, the board shall fix a time therefor
shall notify the commissioner, regardless of
ther or not he had appeared or been represented
he hearing before the referee, and any other party
cted, provided such other party appeared at the
ring before the referee. The board may affirm or
erse, wholly or in part, or may modify the decision
pealed from and shall render its decision promptly
shall thereupon send written notice thereof to-

gether with the reasons therefor to the commissioner and any other party affected thereby who appeared at the hearing before the referee."

"§ 624. Appeals to courts

Within thirty days after the mailing or personal delivery of notice of a decision by the appeal board, the commissioner or any other party affected thereby who appeared at the appeal before the board may appeal questions of law involved in such decision to the appellate division of the supreme court, third department. The board may also, in its discretion, certify to such court questions of law involved in its decisions. Such appeals and the questions so certified shall be heard in a summary manner and shall have precedence over all other civil cases in such court except cases arising under the workmen's compensation law. The commissioner shall be represented in court by the attorney general without additional compensation. An appeal may be taken from the decision of such court to the court of appeals in the same manner and subject to the same limitations, not inconsistent herewith, as is provided for in civil action. It shall not be necessary to file exception to the rulings of the appeal board. No bond shall be required to be filed upon an appeal to the appellate division or to the court of appeals except as hereinafter provided. Upon final determination of an appeal, the appeal board shall enter an order in accordance with such determination."

APPENDIX

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT—
October Term, 1953

No. 132

Argued February 2, 1954 Decided April 27, 1954

Docket No. 22860

SWORD LINE, INC., *Appellant,*

v.

INDUSTRIAL COMMISSIONER OF THE STATE OF NEW YORK,
Appellee

Before Clark, Frank and Hincks, *Circuit Judges*

Appeal from the United States District Court for the Southern District of New York, Sylvester J. Ryan, Judge. Reversed and remanded.

R. H. Guthrie, New York City (Mudge, Stern, Williams & Tucker and Ara P. Blanc, New York City, on the brief), for appellant.

Samuel Stern, Asst, Atty. Gen. of the State of New York (Nathaniel L. Goldstein, Atty. Gen. of the State of New York, Wendell P. Brown, Sol.-Gen., and Francis R. Curran, Asst. Atty. Gen., on the brief), for appellee.

The debtor filed a petition for an arrangement under Chapter XI of the Bankruptcy Act, 11 U. S. C. §§ 701 *et seq.*, on July 30, 1948. On that same day the petition was approved and the court made an order enjoining and staying until final decree all persons from the commencement of any suit against the debtor. On July 24, 1950, respondent-appellee, the Industrial Commissioner of the State of New York, filed a proof of claim in the amount of $98,209.97, representing unpaid pay roll contributions from October 1, 1946, to July 30, 1948, of $88,199.82, plus interest of $9,-961.14 computed to July 30, 1950, and interest on the late payment of $49.01. The debtor filed objections to this claim on the ground that interest could be allowed only to

July 30, 1948—the date of the filing of the petition for arrangement. Before the hearing on these objections and following the decision of the Supreme Court in *United States* v. *General Engineering & Mfg. Co.*, 342 U. S. 912, which had been awaited, respondent, on April 18, 1952, filed an amended proof of claim in the amount of $88,592.31, which included interest only to July 30, 1984. The State did not apply to the court for leave to amend the claim; the debtor did not agree to the amendment. The claim was allowed on July 2, 1952, and has been paid in full according to a plan of arrangement confirmed July 31, 1952, under which claims entitled to priority were paid in full and claims not so entitled were paid in part, but in each case without interest beyond July 30, 1948.

On June 4, 1952, respondent, without leave of the bankruptcy court, filed in the office of the County Clerk of New York, pursuant to § 573(2) of N. Y. Labor Law, a warrant in the amount of $119,068.54, representing the claim as allowed, plus penalties and interest computed to May 31, 1952, in the amount of $30,476.23.

On July 2, 1952, the debtor moved before the Referee for (1) an order expunging the warrant from the state judgment docket, (2) a permanent injunction against any proceeding by the respondent against the debtor outside the bankruptcy court, and (3) a determination of the question whether or not interest arose on the claim of respondent after July 30, 1948. The Referee found, as a "conclusion of law," that respondent was not entitled to interest on his claim beyond the date of the filing of the debtor's petition for an arrangement; accordingly he granted debtor's motion. Respondent petitioned for review of this order to the United States District Court, which vacated the injunction and held, *inter alia*, that the order of the Referee "is not to be construed as an adjudication that the claim of the Industrial Commissioner for interest and penalties accrued since July 30, 1948 is either invalid or has been paid." It did continue a temporary injunction until entry of the final decree and did order the warrant expunged from the judgment docket—an order which has been complied with. At the time of the hearing below a

final decree had not been entered in the arrangement proceedings.

CLARK, *Circuit Judge:*

It is conceded, as it must be in the light of relevant Supreme Court decisions, that bankrupt estates cannot be directly used to pay post-bankruptcy interest on claims against the bankrupt for unpaid taxes. This was settled for ordinary bankruptcy by the leading case of *City of New York* v. *Saper*, 336 U. S. 328; for proceedings in reorganization by *United States* v. *Edens*, 342 U. S. 912 affirming 4 Cir., 189 F. 2d 876; for proceedings by way of arrangement by *United States* v. *General Engineering & Mfg. Co., supra*, 342 U. S. 912, affirming 8 Cir., 188 F. 2d 80, and see *Commonwealth of Massachusetts* v. *Thompson*, 1 Cir., 190 F. 2d 10, certiorari denied 342 U. S. 918; and even for a general assignment under N. Y. Debtor & Creditor Law by *United States* v. *Bloom*, 342 U. S. 912, affirming *Pavone Textile Corp.* v. *Bloom*, 302 N. Y. 206, 97 N. E. 2d 755. This appeal raises the question whether, notwithstanding this current of authority, such interest may nevertheless be collected by direct action against a debtor after confirmation of its arrangement in Chapter XI proceedings.

It is the position of the State of New York, vigorously asserted here and elsewhere, that such collection may be made by using the ordinary remedies available against solvent debtors.[1] And this view appears to have been substantially the view of the district court in reversing the decision of the referee in bankruptcy for the debtor, although it did refrain from a final adjudication.[2] But since

[1] This is made most clear not only by respondent's specific contentions herein, but also by his citation to us, as correct and authoritative, of a decision by a referee in the Unemployment Insurance Referee Section of the State Department of Labor—Case No. E2340-53R, *Starrett Television Corp.*—holding an employer liable for interest on unpaid taxes during the pendency of arrangement proceedings in reliance on Judge Ryan's decision in this case.

[2] In view of this and of the fact that respondent has not appealed from the order expunging the warrant from the state judgment docket, it may be suggested that injunctive relief now is premature. But the expunging

a plan of arrangement recognizing the insolvency of this bankrupt has been confirmed and payments made to carry it out, the issue is before us and must be decided. Particularly in the case of a reorganized or "arranged" corporation such as this is it clear that the State's position calls for payment of interest before the debtor can go ahead with its activities. That is, the Supreme Court rulings cannot then accomplish what they seem intended to do; on the contrary, they will lead in actuality to simpler and harsher collection of the tax interest than if ordered through the medium of reorganization or arrangement. We do not believe that all this history and decision can really have been intended to produce so pyrrhic a result.

The basis of the State's claim rests upon the provisions in the Bankruptcy Act for priority and nondischargeability of tax claims and the complete assimilation of post-bankruptcy interest to the taxes themselves. Thus §371 of the Act, 11 U. S. C. §771, provides that the confirmation of an arrangement shall not discharge debts not dischargeable under §17, 11 U. S. C. §35, while §17 excepts from discharge debts as "are due as a tax levied by the United States, or any State, county, district, or municipality."[3] In §354 as now amended, 11 U. S. C. §755, it is provided that, when an order in an arangement proceeding is entered directing that bankruptcy be proceeded with, only claims for taxes legally due and owing to the United States or any State or any subdivision thereof at the time of the filing of the original petition under this title," together with the or-

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of the direct holding by the referee in bankruptcy which would have settled the question, the absence now of any adequate protection for the plan of arrangement, and the direct threat of steps to collect, see note 1 *supra*, convince us that action is now necessary.

[3] The provisions of § 226, 11 U. S. C. § 626, applying to reorganization proceedings, are somewhat differently framed, being to the effect that the *property* dealt with by the plan is free and clear of creditors' claims, and there is no specific exception for claims allowable under § 17, 11 U. S. C. § 35. But there is nowhere any suggestion that reorganization proceedings should be treated differently from those in ordinary bankruptcy or of arrangement; and, as we have seen, the *Saper* rule actually developed in a case of ordinary bankruptcy. Of course a differentiation between these proceedings would be most unfair and inequitable, and the rationale developed later in this opinion avoids necessity for any attempt to make it.

dinary provable claims, §63, 11 U. S. C. §103, "shall be allowed."[4] Since there is nothing in the Act which specifically covers either the allowance or the nondischargeability of interest on taxes, such a claim if based affirmatively on the statute must be brought within the terms here cited to gain the special immunity claimed. But the language is not apt for the purpose—thus such interest is hardly a tax "legally due and owing" at the time of the filing of the petition; and the history of the status of such claims and their treatment judicially is persuasive to the contrary. Nor can the State rest on the statute's silence and the assumption that claims survive unless expressly cut off. For we think the contrary true under the scheme of the Act.

Before the matter was settled by the ruling in the *Saper* case there had been sharp differences of view among federal judges and commentators on the issue—a situation not unnatural in view of the absence of statutory mandate. Without pausing here for a full citation of opposing authorities, we may refer to the able decision in favor of allowance of interest in *Davie* v. *Green*, 1 Cir., 133 F. 2d 451, which persuaded two of our colleagues, *Carter* v. *United States*, 2 Cir., 168 F. 2d 272, and was relied on by the dissenting justice in the *Saper* case, 336 U. S. 328, at page 341. Our opposing decision in *Saper* v. *City of New York*, 2 Cir., 168 F. 2d 268, produced a conflict in and among circuits which led to the Supreme Court review settling the issue, *City of New York* v. *Saper, supra*, 336 U. S. 328.

The approach to the issue of Justice Jackson, speaking for the Court in this decisive case, is instructive. First is his initial statement of the problem: "The ultimate issue in these three cases is whether tax claims *against a bankrupt bear interest* until date of bankruptcy, as held by the court below, or until payment, as previously held by another Court of Appeals." (Italics here and later supplied.) He continues: "More than forty years ago Mr. Justice Holmes wrote for this Court that the rule *stopping interest at bankruptcy* had then been followed for more

[4] The corresponding section of Chapter X, § 238(3), 11 U. S. C. § 638(3) as amended, is identical in the language quoted.

than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied." Then after finding logical implications to the same effect in §63(a)(1) and (5), 11 U. S. C. §103(a)(1) and (5), and §57(j), 11 U. S. C. §93(j)—the latter dealing specifically with debts owed the United States or any state or subdivision thereof—he continues: "Moreover, there is no interest except that which accrues according to law—it is exactly such interest that the 'fundamental principle' cuts off as of bankruptcy. Section 57(n), 11 U. S .C. §93(n), requires governmental claims to be proved in the same manner and within the same time as other debts and only for cause shown may a reasonable extension be granted. Tax claims are treated the same as other debts except for the fourth priority of payment, §64(a), 11 U. S. C. §104(a), and the provision making taxes nondischargeable, §17, 11 U. S. C. §35. But each of these sections is silent as to interest." Then he makes an extended analysis of the case authority and later amendments of the Bankruptcy Act to state: "The Court of Appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated taxes to other debts *for all purposes,* including *denial of post-bankruptcy interest.* We think this is a sound and logical interpretation of the Act after those amendments to §§64(a) and 57(n)." 336 U. S. 328, at pages 329, 330, 331, 332, 337, 338.

So conclusive did this reasoning and decision seem to us that recently when the State of New York again made a like contention to us, we rejected it, citing particularly the last quotation made above. In *State of New York* v. *Feinberg,* 2 Cir., 204 F. 2d 502, 503, Judge Kaufman approved a plan of reorganization of Huyler's, Inc., which granted the State on bonds issued for unpaid unemployment taxes only such interest as other bondholders of like class were to receive, not the 9 per cent per annum provided for this tax by New York law. It is obvious that we could not properly have affirmed the approval of the plan, which made no provision for the contingency, if the law would permit the State to make later collection of the additional

amount. But in fact we referred to the principle that even governmental priorities were "fully discharged upon consummation of the final plan of reorganization"; said that "it would seem anomalous that sometime later there might be a revivification of priorities once terminated"; and held the matter settled in favor of the power exercised by the trial judge under the *Saper* ruling that Congress had assimilated taxes to other debts "for all purposes, including denial of post-bankruptcy interest." And see also *Pavone Textile Corp.* v. *Bloom, supra,* 302 N. Y. 206, at page 211, 97 N. E. 2d 755, making a like analysis of both federal and New York statutes.

The argument to the contrary appears, so far as we understand it, to be based upon the assumed premise that interest is merely "suspended" during the period of bankruptcy and, not being specifically denominated as discharged, therefore revives after termination of proceedings. This is a large premise, with a generous and uncompelled, if not surprising, conclusion. Thus stated the difficulty appears to be only semantic and, if the reasons of policy and history are as strong as the Supreme Court has indicated, should yield to semantic remedies. And it is little compliment to the Supreme Court, whose skillful and persuasive rationale in the *Saper* case met and surmounted the major issue, to hold that it would be balked by this limited and already indicated subordinate step, so much so, indeed, as to nullify for all practical effect its prior carefully considered holding.

The holding that interest is only suspended is a deduction from two stated "exceptions" to the English rule cited approvingly in the *Saper* case, 336 U. S. 328, at page 330, n. 7, *viz.,* (1) that if the alleged bankrupt proved solvent, creditors received post-bankruptcy interest before any surplus reverted to the debtor; and (2) that if securities held by a creditor as collateral produced interest or dividends during bankruptcy, these amounts were applied to post-bankruptcy interest. These exceptions, be it noted, were general, without peculiar application to tax claims. The first exception was applied (without resort to the rationale of interest as "suspended") in *Johnson* v. *Norris,* 5 Cir.,

190 F. 459, appeal dismissed *Norris* v. *Johnson,* 232 U.S. 715, and in *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Ry.,* 233 U. S. 261, 267, a receivership case, where the Court said: "For, manifestly, the law does not contemplate that either the debtor or the trustees can, by securing the appointment of receiver, stop the running of interest on claims of the highest dignity." See for a late acute discussion *In re Macomb Trailer Coach,* 6 Cir., 200 F. 2d 611, certiorari denied *McInnis, Trustee* v. *Weeks,* 345 U. S. 958, noted in 27 J. N. A. Ref. Bankr. 122, supporting a third exception, namely where the value of the security is more than sufficient to pay both the principal and interest thereon to date of payment of the claim secured thereby. Since the Supreme Court has not yet settled the extent and nature of these suggested exceptions, it may be premature to base an extended argument upon their existence; in pursuance of an overriding policy the Court may ultimately think it not desirable to allow any at all. Nevertheless we do not perceive real difficulty in accepting them if the Court so desires. But in that case these further suggestions seem in point.

To denominate uncollectible interest as merely *suspended* seems of itself a solecism. It reminds of Dean Ames' classic statement: "An immortal right to bring an eternally prohibited action is a metaphysical subtlety that the present writer cannot pretend to understand." Lectures on Legal History 199 (1913). But, however it be denominated, of course the fact, rather than the label, controls. And the reiterated fact throughout the cases, and the basis of the extensive rationale, is—as we have seen by the quotations above—that interest ceases upon bankruptcy in the general and usual instances noted and unless the bankruptcy bar proves eventually nonexistent by reason of the actual solvency of the debtor.[5] The discretionary control of a court over interest not based on a contract is traditional. See *Redfield* v. *Ystalyfera Iron Co.,* 110 U. S. 174, 176; *Red-*

[5] This is discussed as one interpretation of the Court's *Saper* opinion in a Note, 58 Yale L. J. 982, 992, before the later re-enforcing decisions —although the writer appears to presume in favor of the alternative accepted below.

field v. *Bartels*, 139 U. S. 694, 701. And this is but a response to both policy and federal statutory control. Particularly when it appears that failure thus clearly to carry the logic of the policy announced by the Court to its natural conclusion is effectually to deny realistic operation of the policy itself, do we feel that the outcome here stated is that intended by the Court.

The decision below denying this effect to the arrangement proceedings is therefore error. While injunction against state proceedings is undesirable, it is nevertheless recognized as necessary where preservation of federal dispositions in bankruptcy and protection and enforcement of federal decrees in legal rehabilitation of corporations are necessary. *Ciavarella* v. *Salituri*, 2 Cir., 153 F. 2d 343; *Evans* v. *Dearborn Machinery Movers Co.*, 6 Cir., 200 F. 2d 125; *Local Loan Co.* v. *Hunt*, 292 U. S. 234, 93 A. L. R. 195; and see also *Halpert* v. *Engine Air Service*, 2 Cir., April 27, 1954. It may be that on remand of this action, injunctive relief will no longer be necessary; but if it is shown to be, then the district court has power to act.

Reversed and remanded for proceedings in accordance with this opinion.

FRANK, *Circuit Judge*, dissenting:

1. The cases cited by my colleagues (which I shall discuss later) have decided only that post-petition interest on a tax claim is not allowable unless the debtor become solvent during the bankruptcy proceeding. A different question is before us here, *viz.* whether confirmation of a Chapter XI arrangement discharges such interest if it has not been allowed (*i. e.*, when the debtor has not thus become solvent). No court has heretofore considered this question.

My colleagues say, in effect, that (1) it having been held such interest is not allowable, it would be absurd (2) to hold nevertheless that it is not discharged. I think it not at all absurd. For a discharge in ordinary bankruptcy or a confirmation of a Chapter XI arrangement leaves undischarged many un-allowed claims which may be immense in magnitude.

In ordinary bankruptcy, the other creditors usually have

no concern with undischarged claims.[6] But not so in a Chapter XI case. For there the assenting creditors often look solely to the debtor's property for payment, yet, after confirmation that property—thanks to § 17 (11 U. S. C. Sec. 35)—may be subjected to huge undischarged claims which often are unknown to, and unknowable by, the assenting creditors at the time when the court confirmed the arrangement. Such unknown and unknowable claims include, among others, the following:[7] (1) liabilities for obtaining property by false pretenses or false representations, (2) unprovable liabilities for willful and malicious injuries, (3) debts not duly scheduled of creditors who had no notice or no actual knowledge of the bankruptcy proceeding, (4) debts created by fraud, embezzlement, misappropriations or defalcations, while the debtor acted in a fiduciary capacity. To the extent that the undischarged claims are known and definite in amount, the assenting creditors act with their eyes open. But often the assenting creditors are unaware and cannot learn of either the existence or the amount of many undischarged claims which may add up to many thousands of dollars and utterly disrupt the arrangement. In this respect, any Chapter XI arrangement is undeniably vulnerable, as a Chapter X plan is not.

For Chapter X provides in § 226 and § 228 (11 U. S. C. § 626 and § 628) that a confirmation order wipes out all claims not expected in the plan, or the order, as against the debtor's property dealt with by the plan.[8] But Chapter

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[6] Nor usually is the debtor if it is a corporation. Cf. *Saper* v. *City of New York*, 168 F. (2d) 268, 272 (C. A. 2).

[7] See § 17, 11 U. S. C. § 35.

[8] Section 226 reads: "The property dealt with by the plan, when transferred by the trustee to the debtor or other corporation or corporations provided for by the plan, or when transferred by the debtor in possession to such other corporation or corporations, or when retained by the debtor in possession, as the case may be, shall be free and clear of all claims and interests of the debtor, creditors, and stockholders, except such claims and interests as may otherwise be provided for in the plan or in the order confirming the plan or in the order directing or authorizing the transfer or retention of such property."

Section 228 reads in part as follows: "Upon the consummation of the plan, the judge shall enter a final decree (1) discharging the debtor from

XI—see § 371 (11 U. S. C. § 771)—incorporates § 17 as Chapter X does not, with the result that claims not discharged under § 17 are undischarged by confirmation of a Chapter XI arrangement.[9]

In 8 Collier, Bankruptcy (14th ed.) p. 1259, it is said that "the discharge provisions of Chapter X are radically different from those of Chapter XI in that debts which are not discharged under § 17 of the Act are not excluded from the operation of a discharge under Chapter X." At pp. 1267-1270, Collier says: "Section 371 specifically excludes from the operation of the discharge 'such debts as, under section 17 of this Act, are not dischargeable.' Chapter X does not make the same exception; while some consideration was given to excluding from the discharge under Chapter XI only some of the debts specified in § 17, all of those debts have been excluded by § 371." And at pp. 1270-71, Collier says: "An arrangement and its provisions, upon confirmation of the arrangement, are binding upon all creditors, including the holders of debts which are not discharged. That, however, does not affect the liability of the debtor upon the debts not discharged. If a creditor's debt was not discharged because he was not provided for in the arrangement, it is clear that he may immediately proceed against the debtor to enforce collection. But where a creditor is provided for in the arrangement, and his claim is nevertheless not discharged under § 371, the problem is suggested as to the exact extent of that creditor's rights. Thus, if the arrangement provides that creditors are to receive 20% in full settlement of their claims one month after confirmation, the right of the creditor whose debt is not discharged to enforce collection of the remain-

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all its debts and liabilities and terminating all rights and interests of stockholders of the debtor, except as provided in the plan or in the order confirming the plan or in the order, directing or authorizing the transfer or retention of property. * * *"

[9] Section 371 reads: "The confirmation of an arrangement shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement, except as provided in the arrangement or the order confirming the arrangement, including the claims specified in section 355 of this title, but excluding such debts as, under section 17 of this title, are not dischargeable."

ing 80% is clear. But the problem is whether he can immediately sue the debtor for the full amount of his original claim, or whether he can immediately sue for only 80%, and must await payment of the other 20% pursuant to the terms of the arrangement. It seems clear that he can immediately sue for the full amount, and such was the apparent intention of the framers of the Act. The creditor has the right to share in distribution, but the discharge consequent upon confirmation does not affect his original claim, which may therefore be immediately enforced in full. Where the creditor has actually received some payment under the distribution upon confirmation, that payment, of course, must be credited against the claim."

The courts can do nothing to overcome this serious defect in Chapter XI. Congress alone, by future legislation, can remove it. Accordingly, we must answer the question here, recognizing this great gap in Chapter XI. (I note in passing that, if post-petition interest on taxes is not discharged, the assenting creditors, as to such interest, take a known risk, because the amount of such interest is precisely ascertainable.)

2. Outside bankruptcy, interest on a claim for a fixed sum is ordinarily an integral part of the principal. The Bankruptcy Act so treats pre-petition interest. Does it treat differently post-petition interest? I think not. The cases, cited by the Supreme Court in *New York* v. *Saper*, 336 U. S. 328 at 330 footnote 7, as stating the correct rule, hold (1) the interest accruing during the bankruptcy has come into existence but that it is "suspended," or is "still running" during that period, and, significantly, that (2) such interest is a part of the debt for which no new or separate proof of claim is required to enable the creditor to collect it in the event of solvency which the bankruptcy proceedings are pending. See *Johnson* v. *Norris*, 190 F. 459 (C. A. 5, cited with approval in *American Iron Co.* v. *Seaboard Air Line Ry. Co.*, 233 U. S. 261.[10] *Johnson* v. *Norris*, *supra*, cites many previous decisions to the same effect.[11]

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[10] Cf. *Ryerson & Son* v. *Peden*, 318 Ill. 105, 109-110.

[11] *Brown* v. *Leo*, 34 F. (2d) 127, 128 (C. A. 2), cites *Johnson* v. *Norris* with approval.

In *Johnson* v. *Norris*, a bankruptcy proceeding where it turned out that the assets in the hands of the bankruptcy trustees exceeded the amount of the debts plus pre-petition interest, the court held that post-petition interest must be paid, ruling as follows (190 F. at 465): "It is said that subsequently accruing interest should not be paid because it has never been proved as a debt. We do not think this objection is sound. The proof of an interest-bearing claim is proof of the interest collectible on such claim. Interest is an incident of, a part of, the debt, and no separate proof is required." In *American Iron Co.* v. *Seaboard Air Line*, the Court, in an equity insolvency case, after referring to the usual rule that interest is not allowed after an insolvent's property is in *custodia legis*, continued (233 U. S. at 266-267): "But that rule did not prevent the running of interest during the Receivership; and if as a result of good fortune or good management, the estate proved sufficient to discharge the claims in full, interest as well as principal should be paid. Even in bankruptcy, and in the face of the argument that the debtor's liability on the debt and its incidents terminated at the date of adjudication and as a fixed liability was transferred to the fund, it has been held, in the rare instances where the assets ultimately proved sufficient for the purpose that creditors were entitled to interest accruing after adjudication. 2 Blackstone's Comm. 488; Cf. Johnson v. Norris, 190 Fed. Rep. 459, 460 (5)."

In 3 Collier (14th ed.) 1838-1839, it is said: "The principle that interest stops running from the date of the filing of the petition in bankruptcy should be understood as a rule of liquidation practice rather than as a rule of substantive law that the creditor of an interest-bearing claim is not entitled to interest beyond the filing date. The overwhelming majority of bankruptcy cases end with the distribution of a dividend that is far from satisfying the creditors even as to the principal. Disputes over interest thereby become largely academic. But it would not be accurate to allow this quantitative element to create a confusion as to what is the rule and what the exception. In liquidating interest-bearing claims, the computation of interest must be made as of some fixed date. The law selects as decisive

the date of the filing of the petition in bankruptcy. It disregards, for the purposes of liquidation, interest accruing beyond that date. Yet this is primarily a technical device to cope in the most convenient and equitable manner with the debtor's apparent insolvency. True, most cases of bankruptcy liquidation are, as it were, ripe for the surgical operation saving the patient's life by amputating his debts. As to such cases the denial of interest accrued after the filing date, in its origin more a provisional method of calculation, becomes the final word. But in some cases the estate is sufficient to take care of the interest accrued after the filing date, and in this situation the debtor will not be handed over the residue without previous distribution to the creditors of such after-accrued interest up to the day of payment. Though numerically undoubtedly a negligible minority, these cases of ultimate solvency instance what is truly the rule rather than the exception, namely that a debtor should pay interest up to *the day of payment*, a rule whose operation is merely suspended where a debtor is so hopelessly insolvent that he is unable to pay even the provable part of a claim, namely principal and interest accrued prior to bankruptcy."

Now turn to Section 17 (11 U. S. C. Sec. 35).[12] It provides that a discharge releases all "provable" debts "whether allowable in full or in part" except (*inter alia*) "such as are due as a tax levied by * * * any State." Applying this provision, we have this result: All the interest on a tax—the pre-petition and the post-petition interest—constitutes a "provable" part of the tax claim. But—absent solvency during bankruptcy—the total tax claim, including all that interest, is "allowable" only "in part." The "part" consisting of post-petition interest is the "part" not "allowable" unless solvency occurs during bankruptcy. Consequently, were it not for the exception as to taxes contained in Section 17, the post-petition interest would be discharged (when the estate remains insolvent during bank-

[12] Section 17 reads in part as follows: "A discharge in bankruptcy shall release a bankrupt from all his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States or any State. * * * "

ruptcy). But that exception saves it from discharge in the case of an insolvent estate.[13]

The very cases cited by my colleagues—*Redfield* v. *Ystalyfera Iron Co.*, 110 U. S. 174, and *Redfield* v. *Bartels*, 139 U. S. 694, 701—hold that where "interest is reserved expressly in the contract, or is implied by the nature of the promise, it becomes part of the debt, and is recoverable by right * * *," its recovery not being "discretionary." As the New York statute expressly provides for interest on the tax here, it is part of the tax claim, and its recovery is not (as my colleagues suggest) within "the discretionary control of the court."

3. The cases my colleagues cite decide nothing contrary to my position. In *Saper* v. *New York*, 168 F. (2d) 268 (C. A. 2), where the sole issue was of the allowability of post-petition interest on a tax claim in an ordinary bankruptcy case, we explicitly left the question open, saying (p. 271): "No cases appear to have held that interest thus survives beyond the principal claim which gives it birth. But assuming, *arguendo*, that interest is not discharged upon payment of the tax claim, we do not see how that fact can be decisive on the present issue." Accordingly, the Supreme Court, in affirming our decision—*New York* v. *Saper*, 336 U. S. 329—did not face the present problem. An article in 58 Yale L. J. (1949) 982, 992, *Interest on Tax Arrearages After Bankruptcy*, discussing the *Saper* case, says, "Presumably * * * the case holds only that interest accruing after a petition is filed is not provable; it does not seem to affect the proviso of Section 17 that bars discharge of tax claims not satisfied out of a debtor's estate."[14]

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[13] Section 755, added by amendment in 1952, provides that, upon the entry of an order in a Chapter XI proceeding directing "that bankruptcy be provided with, only claims for taxes legally due and owing at the time of the filing of the original petition and such claims as are provable under Section 63 shall be allowed. * * * "

This provision does not at all affect Section 17 as to the discharge of any "part" of a provable tax claim which is not "allowable" in an insolvent estate. Just as before the 1952 amendment, the post-petition interest is included in the provable tax claim; but is a part not "allowable" unless solvency occurs during bankruptcy.

[14] Footnote 35, p. 989, refers to the legislative history showing that Congress has refused to amend Section 17 so as to discharge claims.

Inapposite is *United States* v. *Edens*, 189 F. (2d) 876 (C. A. 4), affirmed without opinion in 342 U. S. 912. There the Court merely decided, on the basis of the *Saper* case, that post-petition interest on a tax claim was not allowable in a Chapter X case. No more in point are similar rulings in respect of Chapter XI arrangements—*United States* v. *General Engineering & Mfg. Co.*, 188 F. (2d) 80 (C. A. 8), affirmed without opinion in 342 U. S. 912, and *Massachusetts* v. *Thompson*, 190 F. (2d) 10 (C. A. 1)—or, in respect of a general assignment—*Pavone Textile Corp.* v. *Bloom*, 302 N. Y. 206, affirmed without opinion *sub. nom. United States* v. *Bloom*, 342 U. S. 912.

New York v. *Feinberg*, 204 F. (2d) 502 (C. A. 2), is surely not pertinent. In the first place, it related to a confirmed Chapter X plan, and, as already noted, such confirmation eliminates all post-confirmation claims not excepted from the plan as against all the debtor's property covered by the plan. In the second place, the State—no doubt because of that Chapter X provision—expressly disavowed any right to interest accruing during the bankruptcy.[15] Our opinion so stated as follows: "The State of New York does not object to the failure to pay interest during the reorganization proceedings. * * *" The State advanced this sole contention: The Plan allotted to all unsecured creditors—including the State for its pre-petition taxes—debentures bearing interest at 6%; but for the bankruptcy, the State's tax claim, under a state statute, would have carried interest at 9%, while the other creditors would have been entitled to a smaller rate; the plan was therefore unfair in not giving the State, through the debentures, 9% for the post-confirmation period. In affirming the order which confirmed the plan, we held the plan fair. This amounted to saying no more than that the rate of interest on new securities under a Chapter X plan need not vary according to the varying interest rates to which the several creditors had been entitled before bankruptcy. Patently, then, the *Feinberg* case did not involve the question confronting us here.

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[15] The debtor retained no property not covered by the plan.

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 27th day of April one thousand nine hundred and fifty-four.

Present: Hon. Charles E. Clark, Hon. Jerome N. Frank, Hon. Carroll C. Hincks, Circuit Judges.

In the Matter of SWORD LINE, INC., *Debtor-Appellant*, INDUSTRIAL COMMISSIONER OF THE STATE OF NEW YORK, *Appellee*

Appeal from the United States District Court for the Southern District of New York

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and action remanded for proceedings in accordance with the opinion of this Court with costs to the appellant.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

(S.) A. DANIEL FUSARO,
Clerk.

(6100)

FILED
JUL 27 1954
HAROLD B. WILLEY, Clerk

Supreme Court of the United States

OCTOBER TERM, 1954.

No. 214.

INDUSTRIAL COMMISSIONER OF THE STATE OF NEW YORK,

Petitioner,

against

SWORD LINE, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENT IN OPPOSITION.

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SWORD LINE, INC.,
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENT IN OPPOSITION.

Opinions Below.

The opinions below are given in the petition. The opinion of the Court of Appeals is now reported in 212 F. 2d 865 (1954).

Jurisdiction.

The jurisdictional requirements are adequately set forth in the Petition.

Question Presented.

The first of the two questions stated by petitioner is concerning the jurisdiction of the Court of Appeals to rule on the existence of post-arrangement interest. We suggest this is incorrectly stated. The question, if any, would seem to be the jurisdiction of the Referee in Bankruptcy.

Statutes Involved.

Additional pertinent provisions of the Bankruptcy Act are set forth herein where they are mentioned.

Statement.

We add the following to petitioner's statement.

The issue of the existence of post-arrangement interest was pending before the Referee by objection taken to the State's proof of claim and answer to such objection filed by the State (R. 1-2). By order of the Court dated July 30, 1948, the State had been enjoined from commencing any action against the Debtor in the State Court (R. 4). The State was fully cognizant of this order (R. 7). The State, while said issue was pending before the Referee (R. 5), *ex parte* without leave of Court purported to file an amended claim deleting post-arrangement interest and also entered *ex parte* a judgment for such interest in the State Court (R. 6).

The Debtor then brought on said original issue to be heard on July 2, 1952. At the same time the Debtor made a separate motion to have determined that under the Bankruptcy Act interest stopped for all purposes upon the filing of the petition in the case at bar regardless of where it was sought to be collected. This motion was also set down to be heard on said July 2, 1952. As incidental relief under the second motion, the Debtor requested an order directing the expunging of the State Court judgment and for a permanent injunction (R. 19).

The Referee decided from the bench on July 2, 1952 that no interest would run in the case at bar after the filing of Debtor's petition. Orders granting relief requested were to be settled on notice (R. 2). The interest involved amounted to something over $30,000 (R. 18).

On July 31, 1952 (29 days later) the Amended Plan of Arrangement was presented to creditors and the Referee for their approval. The Plan provided for payment *without interest* of unsecured claims as follows: 40% of claims over $5,000; 50% of claims between $5,000 and $1,000 and 60% of claims for less than $1,000. It also provided for payment in full *without interest* on a deferred installment basis to creditors electing to receive such payments over a five year period. The Plan was accepted by creditors and the Referee confirmed it by order entered the same day (R. 2).

The inability of the Debtor to pay its debts in full was not questioned below and the petitioner conceded the Debtor's insolvency at the time of filing the petition.

Argument.

The petitioner presents two questions which it claims warrant the consideration of this Court. The first is:

I.

> "(1) Whether, under the facts and circumstances of this case, the Court of Appeals was correct in its ruling that it had jurisdiction to determine the liability of the debtor for post-arrangement interest after the confirmation of the arrangement and close of the proceeding."

The Court of Appeals reversed the order of the District Court (R. 38) thereby reinstating the ruling of the Referee that petitioner was "not entitled to interest on its claim against the Debtor beyond the date of the filing of the Debtor's petition herein whether said claim be made before this Court or any other forum" (R. 7). No objection was raised below as to the jurisdiction of the Court of Appeals

to entertain the appeal taken to it by the Debtor. We take it then that the question put is intended to question the jurisdiction of the Referee in making his determination.

The Referee decided a necessary question basic to all Chapter XI proceedings. Under Section 366 of the Bankruptcy Act[1] the Court (including by definition the Referee[2]) shall confirm an arrangement if satisfied that it is "for the best interests of the creditors" and it is "fair and equitable and feasible". In order to determine whether these conditions are met, the Debtor's assets and liabilities must be known. Necessary to the ascertainment of liabilities was the Referee's decision as to whether post-arrangement interest existed. If the interest existed, then secondary problems such as the time when it would become payable would, of course, be pertinent, but first the basic issue of its existence had to be determined. It was also necessary from the point of view of creditors to have this liability determined, particularly in the case of creditors considering the relative advantages of taking cash or deferred payments over a five year period.

Petitioner, in his argument (pp. 15-17) on this question, ignores the fact that the Debtor brought on a separate motion to have this issue determined by the Referee and that it regularly came on to be heard and decided by the Referee. The issue was also presented on the original

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[1] Section 366 provides:

"The court shall confirm an arrangement if satisfied that * * * (2) it is for the best interests of the creditors; (3) it is fair and equitable and feasible; * * *"

[2] Section 1 provides:

"The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * * (9) 'Court' shall mean the judge or the referee of the Court of Bankruptcy in which the proceedings are pending."

objection to petitioner's proof of claim. Petitioner's argument is that the amendment to the proof of claim filed *ex parte* removes the issue from the jurisdiction of the Referee. The amended proof of claim certainly had no bearing on the separate motion brought by the Debtor and, furthermore, petitioner overlooks that since the 1938 Bankruptcy Act such issue can only be withdrawn by leave of the Court.*

Although not stated as a question, petitioner also argues (pp. 13-15) that the exercise by the Referee of discretion to grant a permanent injunction warrants review by this Court in that it is in conflict with the decision of this Court in *Local Loan Co.* v. *Hunt*, 292 U. S. 234 (1934). The fact is that in the *Hunt* case, this Court affirmed the decision granting such an injunction. We submit the circumstances in the case at bar were sufficiently unusual to authorize the Referee in his discretion to issue the injunction under the very criteria laid down in the *Hunt* case. *Cf. Ciavarella* v. *Salituri*, 153 F. 2d 343 (C. A. 2nd 1936); *Greenfield* v. *Tuccillo*, 129 F. 2d 854 (C. A. 2nd 1942).

In no event, however, are any of the points above discussed of sufficient importance to require the attention of this Court. It might be noted that the dissenting judge below did not even mention them.

II.

The second question stated by petitioner is:

> "(2) Whether the Court of Appeals erred on the law in concluding that such interest did not arise during the course of the arrangement proceeding and

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* Federal Rules of Civil Procedure, Rule 41(a); *Matter of Empire Coal Sales Corp.*, 45 F. Supp. 974 (S. D. N. Y. 1942), aff'd *sub nom. Kleid* v. *Ruthbell Coal Co.*, 131 F. 2d 372 (C. C. A. 2d 1942). See 3 Collier on Bankruptcy (14th Ed.) 657.12, pp. 177-180.

that the debtor will not be liable therefor after the confirmation of the arrangement and close of the proceeding."

A.

The State first argues that the ruling of the Court of Appeals on this question "is in conflict with applicable decisions of this Court" (p. 7). We submit this contention is incorrect.

The whole subject of interest on tax claims was considered by this Court in *City of New York* v. *Saper*, 336 U. S. 328 (1949). The issue was stated to be: "The ultimate issue in these three cases is whether tax claims against a bankrupt bear interest until the date of bankruptcy, as held by the court below, or until payment, as previously held by another Court of Appeals" (p. 329).

The Court then continued "More than forty years ago, Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied." (p. 330). After considering the changes made in the Bankruptcy Act since the earlier decisions, this Court concluded: "The Court of Appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest. We think this is a sound and logical interpretation of the Act after those amendments * * *. Considered in conjunction with the general rule against post-bankruptcy interest * * * they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims." (pp. 337-338)

The applicability of this rule to a Chapter XI proceeding, to a Chapter X proceeding, and to a general assignment for benefit of creditors was thereafter affirmed by this Court without opinion. *United States* v. *General Engineering & Manufacturing Co.*, 342 U. S. 912 (1952) [Chapter XI proceeding]; *United States* v. *Edens*, 342 U. S. 912 (1952) [Chapter X Proceeding]; *United States* v. *Bloom*, 342 U. S. 912 (1952) [New York Debtor and Creditor Law].

The distinction which petitioner would make of the *Saper* and *General Engineering* cases (although not made in the cases themselves) is that post-petition interest would not be provable in a straight bankruptcy proceeding (*Saper* case) or in a Chapter XI proceeding (*General Engineering* case) and therefore this Court did not necessarily by these cases outlaw post-petition interest for all time. Even if this were true, it hardly establishes the contention (p. 9) that "the bankruptcy rule merely suspends or postpones the accrual of interest during bankruptcy". Furthermore, the language certainly in the *Saper* case is contrary to this view.

The *Edens* case (Chapter X proceeding) is not mentioned in petitioner's brief and would seem inconsistent with petitioner's position. Under the provisions of Section 106 of the Bankruptcy Act* post-petition interest was provable in the Chapter X proceeding if it existed. Post-petition interest, however, was denied also in that case.

Furthermore, the general law applicable to interest is not that stated by the petitioner. The general rule is that, in the absence of a statutory provision, interest stops on

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*Section 106(1) provides:

"(1) 'claims' shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;"

all claims at the date of the beginning of the bankruptcy proceeding. *Sexton* v. *Dreyfus*, 219 U. S. 339 (1911). The rule is repeated in *Vanston Committee* v. *Green*, 329 U. S. 156 (1946):

> "The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings. Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved" (p. 163).

The right of petitioner to be treated differently from other creditors arises, if at all, from Section 64 of the Bankruptcy Act.* Section 64 merely states that taxes legally due a State are entitled to priority. Nothing is said in Section 64 or indeed anywhere else in the Bankruptcy Act about interest on taxes. This Court, in the *Saper* and successor cases, rejected the inclusion of interest under Section 64 in bankruptcy proceedings. Not to claim, however, a statutory position puts the State on the same level of creditors governed by the general rule as set forth above in *Vanston Committee* v. *Green*. What the State requests, as we view it, is to have this Court take this case in order to

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* The applicable portion of this Section provides:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof * * * and *provided further*, that, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court;"

create a special classification which, on the one hand, does not come within Section 64 and yet, on the other hand, is not governed by the rule applicable when Section 64 does not apply. The State points to no statutory or judicial authority for this extraordinary result.

The cases which petitioner presents as representing the rule that interest continues to run in a bankruptcy proceeding are those in which the creditor holds security worth an amount in excess of the principal of the debt or where such security produces interest or dividends during bankruptcy and he could also urge the situation where the debtor becomes solvent. These may or may not be, today, exceptions to the general rule but, in any event, they are not even argued to be the situation in the case at bar.

The opinion of the dissenting judge below rests on the premise that interest did not stop when the bankruptcy proceeding was begun. He therefore treats the question in terms of its discharge and thereby reaches the conclusion there is a "serious defect in Chapter XI" (R. 31). But if no interest arose, then the alleged "defect" in the discharge provisions of the Bankruptcy Act is illusory. Birth is a condition precedent to death.

We submit, therefore, that petitioner's contention that the decision below is in conflict with applicable decisions of this Court is without merit.

B.

The State next argues (p. 11) that the decision of the Court below is in direct conflict with New York State court decisions. The State cites as its authority for this proposition *Matter of Paley* (*Ritholtz*), 285 N. Y. 641 (1941), aff'g 260 App. Div. 632. The pertinent issue in this case was whether or not a judgment in the State Court properly included post-bankruptcy interest. The Court's

position was that debtors "who voluntarily permit[ted] the continuance of the litigation in the State court in the hope of defeating the claim there and getting a judgment for themselves for costs against the claimant" (260 App. Div. at 636) fall under special sections of the Bankruptcy Act there quoted applicable to this special situation.

The Court expressly recognized the normal rule to be "It is true that where, as here, the assets of the estate in bankruptcy are less than the liabilities, interest stops on unsecured debts at the time of filing the petition * * *. The cessation of interest on unsecured debts, where the assets are not sufficient to pay the claims in full, refers only to interest accruing against the estate in bankruptcy; it does not refer to interest that has ripened into a right against the bankrupt himself after the petition and before the discharge, by reason of the bankrupt's election to continue to litigate his liability in another forum." (260 App. Div. at p. 636).

This case is obviously not authority for the proposition for which it is cited aside from the fact it was decided some years before the law was clarified in the *Saper* case.

On the other hand, the very tax here involved was considered after the *Saper* case by the Court of Appeals of the State of New York in *Matter of Pavone Textile Corp.*, 302 N. Y. 206 (1951), aff'd *sub nom. United States* v. *Bloom*, 342 U. S. 912 (1952). The question presented was whether or not interest stopped upon an assignment for benefit of creditors under the New York Debtor and Creditor Law. The Appellate Division for the First Department recognized that this Court denied interest on tax claims in bankruptcy proceedings but stated that the contrary rule was provided by the applicable State statute in State insolvency proceedings. The Court of Appeals, however, reversed the Appellate Division and necessarily decided that, as a matter

of statutory construction of the New York statute there involved and here involved, that no interest arose after the filing of a petition.

Thus, we submit, the New York State Court decisions are directly contrary to that urged by petitioner.

C.

The final argument (p. 13) of petitioner under this point is based on the premise that penalties survive bankruptcy. There are separate principles obviously here involved and we cannot see the relevancy of such an argument.

Conclusion.

We therefore submit there is no reason why this Court should grant the writ requested in the case at bar. The decision below is not in conflict with the decisions of this Court or of the New York State courts. It is consistent with the language of these decisions and we think it is compelled by the decision in the *Edens* case. The result requested would vitiate the principle stated in the *Saper* and successor cases. The execption so created to the general rule would in turn create "a serious defect in Chapter XI".

If, nevertheless, this Court wished to consider this question further, we suggest it should wait until there was some diversity in the Courts below on this point, if this should ever occur, and at such time take the matter up for review.

Respectfully submitted,

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July 22, 1954.